

The Name, Image, Likeness (NIL) Tax Game

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ABSTRACT

Name, Image, Likeness, or NIL, and the Supreme Court opinion in *NCAA v. Alston* are changing the tax game for college athletes. The new rules allow student athletes to receive compensation for the use of their name, image, and likeness. The new rules also raise questions about the tax implications to student athletes. Jaxon Masden is a 20-year old student at Guinness University (“University”). Jaxon is on the University basketball team and is known in the community and on a national level as one of the best players in college basketball. Jaxon receives several different types of income during his Junior year at Guinness University including a scholarship from the University, proceeds from a local Pizza shop for the use of his name, an offer of income from a shoe brand for wearing the brand shoes while playing and a two-year deal to be a brand ambassador for a clothing company.

Keywords: tax research, sources of law, scholarships, exempt income, unearned income, kiddie tax

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INTRODUCTION

On June 21, 2021, the United States Supreme Court entered its decision in *NCAA v. Alston*. *Alston* was initiated by student athletes claiming that the NCAA restrictions on compensation for student athletes violated the antitrust rules of § 1 of the Sherman Act. This decision changed the landscape for the NCAA. The *Alston* ruling focuses on “certain NCAA rules limiting the education-related benefits schools may make available to student-athletes.” The analysis of the Court in this limited context and the standard used to evaluate the education-related compensation rules, however, led the NCAA to adjust other compensation-based rules. On June 30, 2021, the NCAA Division 1 Board of Directors approved an interim name, image and likeness (NIL) policy allowing all NCAA D1, D2 and D3 student-athletes to be compensated for their name, image, and likeness effective July 1, 2021.

This case will examine the federal income tax implications of education-based compensation and compensation from a student athlete’s name, image, and likeness. Specifically, it will look at the questions of taxation of scholarship funds, the definitions of earned and unearned income, and the application of the kiddie tax for student athletes.

THE CASE PRESENTED TO STUDENTS

Jaxon Masden is a 20-year old student at Guinness University (“University”) located in Louisville, Kentucky. Jaxon and his parents also reside in Kentucky. Jaxon is on the University basketball team and is known in the community and on a national level as one of the best players in college basketball. Jaxon receives a Scholarship from University for the current academic year in the amount of \$57,940. University’s tuition and fees (which includes parking, printing, course materials) is \$42,970 for the academic year. Jaxon purchases a laptop for his design and analytics courses (required) at a cost of \$4,000. Room and Board at University is \$6,350 per academic year and a meal plan costs \$4,620 per academic year. Jaxon receives the full amount of the scholarship in the current year.

In the current year Jaxon is approached by a local pizza shop near the University. The pizza shop would like to sell a pizza named after Jaxon, the Jaxon Jubilee Pizza. Jaxon will receive 5% of the proceeds from the profits of all sales of the Jaxon Jubilee Pizza. The income received by Jaxon from the sale of the pizza is only for use of his name. Jaxon receives \$3,600 from pizza sales in the current year.

In addition, Jaxon’s uncle, who created his own athletic shoe brand, promises to pay him \$3,900 if he plays in at least 5 games during the current year, and another \$7,800 if he plays in at least 10 games in the Spring of the following year. The contract with his uncle includes allowing the uncle to use pictures of Jaxon wearing the shoes as part of his print and social media advertising campaigns. The University Team has 36 games scheduled this season and it is anticipated that Jaxon will play in every game. 13 games will occur in the current year and the remainder will occur in the following year.

Jaxon also signs a \$20,000 deal to be a two-year brand ambassador with AliCub Clothing, which includes posting pictures on social media wearing brand clothing on game days. The endorsement does not require Jaxon to play in a specified number of games. Jaxon will be paid \$10,000 in the current year and \$10,000 in the following year.

Jaxon is a cash-basis taxpayer who uses the calendar year. He has no other sources of income. His parents are married and file a joint tax return. Their adjusted gross income is

\$185,000 for the current tax year ending December 31. Their taxable income is \$160,400 for the current tax year ending December 31.

TEACHING NOTES

This case explores the federal income tax consequences of income received by student athletes. The case is best suited for accounting majors or those in a Master's in Taxation program. The case can be utilized to teach students about tax research including the use of a database, sources of tax law, written communication and critical thinking skills.

Questions:

1. How much of the income received by Jaxon is included in gross income in the current year?
2. Determine whether each type of income earned by Jaxon is earned or unearned income.
3. Does Internal Revenue Code §1(g), known as the Kiddie Tax, apply to Jaxon's income?

Answers:

1. How much of the income received by Jaxon is included in gross income in the current year?

For the current taxable year, Jaxon will include the following amounts in gross income:

- \$3,600 for the use of his name by the pizza shop owner;
- \$3,900 from his uncle for the shoe endorsement deal;
- \$10,000 for the endorsement deal with AliCub;
- \$10,970 for the taxable scholarship funds.

The \$3,600 of income Jaxon receives from the pizza shop owner is considered royalty income. Courts have consistently characterized payments for the right to use a person's name and likeness as royalty income because the person has an ownership interest in the right. *Goosen v. CIR*. The agreement with the pizza shop owner is strictly for the use of Jaxon's name. Royalty income is included in gross income pursuant to I.R.C. § 61(a)(6).

The income from Jaxon's endorsement deal with his uncle is classified as either royalty income or income from personal services. Personal service income is defined as any income resulting mainly from an individual's personal efforts or skills. Income from personal services is included in the gross income of the person who performs the services. *Lucas v. Earl*. In *Goosen* and *Sergio Garcia v. CIR*, the U.S. Tax Court examined similar endorsement contracts and engaged in an analysis of whether the sponsors primarily paid for services, for the use of an athlete's name and likeness, or for both. For purposes of this first question, the determination of the type of income is immaterial as both royalty income and personal service income are included in gross income. Since Jaxon is a cash-basis taxpayer, he will include \$3,900 in gross income for the current year. For the second question, concerning earned versus unearned income, the instructor should further explore the type of income from the endorsement.

The income from Jaxon's brand deal with AliCub is similar to the deal with his uncle. The income is classified as either royalty income or income from personal

services. Again, for purposes of this first question, the determination of the type of income is immaterial as both royalty income and personal service income are included in gross income. Since Jaxon is a cash-basis taxpayer, the amount included in gross income for the current year is \$10,000.

Jaxon's scholarship from Guinness University is excluded from gross income to the extent the amount is used for qualified expenses. I.R.C. § 117(a). Qualified expenses include amounts paid for tuition and fees for enrollment and "fees, books, supplies and equipment required for courses of instruction." I.R.C. § 117(b)(2). Qualified educational expenses do not include room and board. IRS Pub. 970. Publication 970 specifically notes that "an athletic scholarship is tax free only if and to the extent it meets the requirements discussed earlier [relating to general scholarship exclusion rules]." University tuition and fees for the current academic year total \$42,970. The laptop Jaxon purchases for his design and analytics courses at a cost of \$4,000 is a qualified expense since it is required for instruction. The balance of the Scholarship received by Jaxon, \$10,970, is included in Jaxon's gross income.

The assumption for purposes of the scholarship funds is that Jaxon receives the funds in the current year and the amount of tuition and fees as well as related books, equipment, etc. is fixed. In the event there is any question as to the amount Jaxon will need to expend for qualified education expenses, the timing for inclusion of the taxable portion of the scholarship remains open until the close of the academic year (the following tax year for Jaxon). Prop. Treas. Reg. § 117-6(b)(2).

2. Determine whether each type of income received by Jaxon is earned or unearned income.

Jaxon's royalty income from the pizza shop owner is unearned income. In analyzing the earned versus unearned question in the context of royalty income, the Tax Court has held that only the portion of royalty income that reflects compensation for personal services constitutes "earned income." *Kramer v. CIR*. Since the income from the pizza shop owner is only for the use of Jaxon's name, it is unearned income.

The deals Jaxon has with his uncle and AliCub are less simple than the deal Jaxon has with the pizza shop owner. In *Goosen* and *Sergio Garcia*, the Tax Court engaged in an analysis distinguishing between royalty income and personal service income. Both cases involved endorsement deals for international athletes and tax treaties in effect with foreign countries to prevent double taxation. To determine U.S. taxing jurisdiction, the court considered the type of income received by the athletes and the source of that income. As noted in Question 1, the U.S. Tax Court examined the endorsement contracts in *Goosen* and *Sergio Garcia* and engaged in an analysis of whether the sponsors primarily paid for services, for the use of the athlete's name and likeness, or for both. Although the agreements in *Goosen* and *Sergio Garcia* are more complex than presented for Jaxon, the focus remains the same – is the income from the endorsement for name and likeness only, or is there an element of personal services involved? In *Goosen*, the court determined that allocation was appropriate since *Goosen's* contract required that he play in a certain number of tournaments. *Goosen* at 562-63. The *Goosen* court acknowledged "that precision in making such an allocation is unattainable," but decided based on the facts before it that the use of *Goosen's* name and likeness and his performance in tournaments were equally important. *Goosen* at 562-63.

As such, the court used a 50/50 allocation. In *Sergio Garcia*, the court made clear that the allocation between earned and unearned income is case specific. The facts of each case will dictate the allocation amount.

For the deal between Jaxon and his uncle, students may raise additional questions. How long can Jaxon's uncle use the pictures of Jaxon? Is the agreement for just the current academic year? How is the amount impacted if Jaxon plays in less than 5 games? Since Jaxon is required to play in 5 out of 13 games in the current year, it would be reasonable to use a 60% (unearned)/40% (earned) allocation. Of the \$3,900 received in the current year, \$1,560 is earned and the balance, \$2,340, is unearned.

For the deal with AliCub, the only requirement for the contract is that Jaxon post on game days. There is no piece to the contract that requires Jaxon to play. As such, the income earned from AliCub is unearned income.

The taxable portion of Jaxon's scholarship from University is unearned income. Although the income is reported on IRS Form 1040, U.S. Individual Income Tax Return, Line 1, Wages, Salaries, Tips, etc., the IRS has clearly identified taxable scholarships as unearned income in the 2021 Instructions for Form 8615, Tax for Certain Children Who Have Unearned Income.

3. Does Internal Revenue Code §1(g), known as the Kiddie Tax, apply to Jaxon's income?

Internal Revenue Code §1(g), the Kiddie Tax, was enacted to prevent income shifting between parents and children. If the section applies, the net unearned income of the child is taxed at the parent(s) tax rate(s), or the income can be included on the parent(s) tax return. The bill, as initially proposed, specifically referenced "parental-source unearned income." COMREP ¶11.01 Rate reductions. However, as currently written, I.R.C. §1(g), uses the broader definition in I.R.C. § 911(d)(2) to distinguish between earned and unearned income – "The term "earned income" means wages, salaries, or professional fees, and other amounts received as compensation for personal services actually rendered. . . ."

The Kiddie Tax does apply to Jaxon. The section applies to any child under 18 at the close of the tax year, or who is under 24 and a full-time student; who's earned income does not exceed one-half of the child's support; who does not file a joint return; and who has unearned income great than \$2,200. I.R.C.§1(g)(2); 2021 Instructions for Form 8615. Jaxon is 20 years old, a full-time student at University, and his only earned income is \$1,560. Jaxon's unearned income is \$26,910.

The instructor can ask students to go beyond the simple question of application of the provision. Net unearned income is defined as the gross unearned income of a child minus the sum of the standard deduction allowed for a dependent plus the standard deduction allowed for a dependent, or the itemized deduction amount if the dependent itemizes his/her/their deductions. I.R.C.§1(g)(4). The standard deduction amount for a dependent is the greater of \$1,100 or the dependent's earned income plus \$250. I.R.C. §63(c)(5). Jaxon's standard deduction is \$1,810, his earned income of \$1,560 plus \$250. Jaxon's net unearned income is \$23,290, the difference between his gross unearned income of \$26,910 and \$3,620, double his allowed standard deduction. The \$23,290 of net unearned income will be taxed at Jaxon's parents' tax rate. The total tax calculation for Jaxon is shown in Tables 1 & 2 (Appendix).

Table 1 – Tax on Jaxon’s Net Unearned Income

Jaxon’s Parents Taxable Income	\$160,400
Jaxon’s Net Unearned Income	23,290
Revised Taxable Income	193,690
Tax (Using Rate Schedules)	42,808
Parents Tax Without Net Unearned Income	(32,517)
Tax Attributable to Jaxon’s Net Unearned Income	10,291

Table 2 – Tax on Jaxon’s Non-Parental Income

Jaxon’s Gross Income (Earned and Unearned)	\$28,470
Jaxon’s Standard Deduction	(1,810)
Jaxon’s Taxable Income	26,660
Jaxon’s Net Unearned Income	(23,290)
Jaxon’s Non-Parental Taxable Income	3,370
Jaxon’s Tax (Using Rate Schedules)	337



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